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IN THE

Supreme Court of the United States

October Term, 1959.

No. 543

THE PHILADELPHIA SAVING FUND SOCIETY,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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IN THE

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OCTOBER TERM, 1959.

No.

THE PHILADELPHIA SAVING FUND SOCIETY,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in the above entitled case on July 20, 1959.

CITATIONS TO OPINIONS BELOW.

The Opinion of the District Court is reported in 167 F. Supp. 814, and is printed in the Appendix hereto, p. 1a, *infra*. The Opinion of the Court of Appeals and the Dissenting Opinion of Biggs, Ch. J., are reported at — F. 2d — and are printed in the Appendix hereto, p. 7a, *infra*.

JURISDICTION.

The judgment of the Court of Appeals was entered on July 20, 1959, p. 15a, *infra*. Rehearing was denied on September 22, 1959, Biggs, Ch. J., and Goodrich, J., dissenting. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTIONS PRESENTED.

1. Where all of the facts are stipulated and the case is heard on motion for summary judgment or judgment on the pleadings, does the burden rest upon the Appellant to show in the Court of Appeals that the conclusion of the District Court was "clearly erroneous", failing which the judgment of the District Court must be affirmed even though the Court of Appeals would reach a different conclusion?

2. Did an assessment credit granted to Petitioner (a mutual savings bank) by the Federal Deposit Insurance Corporation (hereafter called "FDIC") in 1952, when Petitioner first became subject to Federal income tax, based upon Petitioner's FDIC assessment in 1951, when it was not subject to income tax, constitute taxable income to Petitioner or was it a nontaxable return of premium?

STATUTES.

The statutory provision involved is Section 7(d) of the Federal Deposit Insurance Act, 64 Stat. 877-878, 12 U. S. C. 1952 ed., Sec. 1817(d), which provides as follows:

> "(d) As of December 31, 1950, and as of December 31, of each calendar year thereafter, the Corporation shall transfer 40 per centum of its net assessment income to its capital account and the balance of the net assessment income shall be credited pro rata to the insured banks based upon the assessments of each bank becoming due during said calendar year. Each year such credit shall be applied by the Corporation toward the payment of the total assessment becoming due for the semiannual assessment period beginning the next ensuing July 1 and any excess credit shall be applied upon the assessment next becoming due. The term 'net assessment income' as used herein means the total assessments which become due during

the calendar year less (1) the operating costs and expenses of the Corporation for the calendar year; (2) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added; and (3) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves. If the above deductions exceed in amount the total assessments which become due during the calendar year, the amount of such excess shall be restored by deduction from total assessments becoming due in subsequent years."

The Federal Rule of Civil Procedure involved is that part of Rule 52(a) which provides:

"Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

STATEMENT.

This was a suit in the United States District Court for refund of 1952 Federal income tax, of which suit the District Court had jurisdiction under 28 U. S. C. § 1346(a).

In 1951, Petitioner, a mutual savings bank, paid to the FDIC an assessment, or deposit insurance premium, based upon one-twelfth of one per cent of its deposit liability. For that year, Petitioner was exempt from Federal income tax. In 1952, when Petitioner and mutual savings banks in general first became subject to Federal income tax, there accrued to Petitioner an assessment credit from the FDIC in the amount of $281,722.05, based upon the assessment Petitioner paid to the FDIC in 1951, which assessment credit Petitioner used in partial payment of its 1952 assessment. Such assessment credit was granted under

Section 7(d) of the Federal Deposit Insurance Act, which was expressly intended by its draftsmen to embody the plan used by mutual insurance companies of paying or crediting "dividends" after the close of the premium year, to the extent that the premium paid for such year was in excess of the amounts necessary to cover losses, expenses, and additions to reserve. Section 7(d) accomplished this by providing that after the end of each year, the FDIC must credit pro rata to all member banks, 60% of the FDIC's net assessment income for the immediately preceding year, which is defined as the total of all assessments due the FDIC, less expenses, losses and an addition to reserve. *Investment income of the FDIC is excluded.*

All of the facts having been stipulated, each party filed a motion for summary judgment or judgment on the pleadings. The District Court granted the motion of Respondent and held that the assessment credit did not constitute the recovery of a portion of Petitioner's 1951 assessment. On appeal, the case was heard by a panel of the Court of Appeals, consisting of Chief Judge Biggs, and Judges McLaughlin and Kalodner. A majority of the panel (Judges Kalodner and McLaughlin) affirmed the judgment of the District Court, holding that the burden was on the Petitioner to show that the District Court "plainly erred" and that it could not conclude that the District Court "clearly erred". Chief Judge Biggs filed a dissenting opinion, holding that the assessment credit was a nontaxable return of premium. Thereafter, Petitioner filed a petition for rehearing before the Court en banc, which Petition was denied on September 22, 1959, with Chief Judge Biggs and Judge Goodrich dissenting. The judges listed on the order denying rehearing as being present were: Chief Judge Biggs, and Judges Goodrich, McLaughlin, Kalodner and Hastie.

REASONS FOR GRANTING THE WRIT.

1. Conflict of Decisions on Applicability of "Clearly Erroneous" Rule.

The decision of the District Court in this case was on a motion for summary judgment or judgment on the pleadings. All of the facts were stipulated. Such stipulated facts dealt primarily with the amounts involved, jurisdictional facts and a description of the process prescribed in Section 7(d) of the Federal Deposit Insurance Act, whereby Petitioner received its assessment credit in 1952 based upon its 1951 assessment and the FDIC's 1951 net assessment income. As pointed out by this Court in *Sartor v. Arkansas Gas Corporation*, 321 U. S. 620 (1944), the District Court could grant the motion of the defendant only if there was no genuine issue as to any material fact and only if defendant was entitled to judgment as a matter of law.

Nevertheless, the Court of Appeals stated that the burden is on the taxpayer to show that the District Court "plainly erred", and concluded that the District Court had not "clearly erred" and was not "plainly wrong". It did so despite the fact that the opinion implicitly recognized that it was dealing primarily with a question of statutory interpretation, since its discussion dealt principally, not with any of the stipulated facts, but with the terms and effect of Section 7(d) and its conclusion (p.11a, *infra*) was: "*In the terms of the Act*, we find no basis for a conclusion that the District Court clearly erred." (Emphasis added.)

Thus, the Court of Appeals refused to make an independent determination of the issue involved. The mere fact that it emphasized so strongly its reliance on the "clearly erroneous" rule indicates that an independent examination of the issue might (and Petitioner believes

would) have resulted in a different conclusion than that reached by the District Court.

In so disposing of the case, the decision of the Court of Appeals conflicts with the decision of this Court in *United States v. United States Gypsum Co.*, 333 U. S. 364 (1948), and numerous decisions in other circuits as well as within the Third Circuit itself.

This Court's decision in the *Gypsum* case has formed the principal available guidance for the lower Federal courts as to the application of the "clearly erroneous" rule of Rule 52(a) where the facts are stipulated or undisputed. However, there is a hopeless conflict among and within the circuits in interpretation of what this Court held in that case, and in many cases the *Gypsum* case is ignored completely. The extent of disagreement in the circuits was pointed out by the Court of Appeals for the First Circuit in *Texas Company v. R. O'Brien & Company*, 242 F. 2d 526 (1st Cir. 1957), where that court stated (p. 529): "Some courts have held Rule 52(a) not to apply where the findings below were based upon stipulated or undisputed subsidiary facts." Then, in a footnote, the Court said: "There is a singular lack of unanimity on this point, not only between, but within, individual circuits.", citing a long list of examples.

The opinion of this Court in the *Gypsum* case, *supra*, seems clearly to conclude, contrary to the decision of the Court of Appeals in this case, that where the facts are undisputed or documentary the "clearly erroneous" rule is not applicable and the appellate court is free to draw its own conclusions from such facts. The impact of Rule 52(a) was set forth by this Court as follows (pp. 394-395):

> "In so far as this finding and others to which we shall refer are inferences drawn from documents or undisputed facts, heretofore described or set out, Rule 52(a) of the Rules of Civil Procedure is applicable. That rule prescribes that findings of fact in ac-

tions tried without a jury 'shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.' *It was intended, in all actions tried upon the facts without a jury, to make applicable the then prevailing equity practice.* Since judicial review of findings of trial courts does not have the statutory or constitutional limitations on judicial review of findings by administrative agencies or by a jury, this Court may reverse findings of fact by a trial court where 'clearly erroneous.' *The practice in equity prior to the present Rules of Civil Procedure was that the findings of the trial court, when dependent upon oral testimony where the candor and credibility of the witnesses would best be judged, had great weight with the appellate court.* The findings were never conclusive, however. A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." (Emphasis added.)

The confusion among the Courts of Appeal in interpreting this statement in the Opinion apparently arises from a misunderstanding of the first sentence thereof, which seems at first glance to be contradictory to the subsequent part (emphasized above) which restricts the "clearly erroneous" rule to situations where there is oral testimony. But the apparent contradiction, when read with the later part of the Opinion applying the principles stated, disappears when it is understood that the language in the first sentence quoted referred to that part of Rule 52(a) which provides that "due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

Thus, where this Court in the *Gypsum* case considered the finding of the District Court which was based upon both

oral testimony and documents (pp. 395-396), the Court concluded that the finding was "clearly erroneous". On the other hand, where a finding was based on uncontradicted evidence this Court made its own inference without regard to the "clearly erroneous" rule, saying (p. 398):

> "The inference *we draw* from the uncontradicted evidence is that the defendants acted in concert to eliminate an important class of jobbers." (Emphasis added.)

That the "clearly erroneous" rule is restricted to the situation where there is conflicting testimony was further confirmed by this Court in *Graver Tank & Mfg. Co., Inc. v. Linde Air Products Co.*, 336 U. S. 271, 275 (1949), where this Court referred to Rule 52(a) as follows:

> "The rule requires that an appellate court make allowance for the advantages possessed by the trial court in appraising the significance of conflicting testimony, and reverse only 'clearly erroneous' findings."

From the foregoing, it is clear that the decision of the Court of Appeals in this case, applying the "clearly erroneous" rule to stipulated facts, considered on motion for summary judgment, conflicts with the decision of this Court in the *Gypsum* case, *supra*.

The decision also conflicts with decisions in other circuits. The conflict with the decision of the Sixth Circuit in *Hamilton Foundry & Machine Co. v. International Molders*, 193 F.2d 209 (6th Cir. 1951), is particularly striking. There the Sixth Circuit held that where the decision of the District Court was on motion for summary judgment, not only does the "clearly erroneous" rule not apply but all inferences must be drawn against the moving party (i.e., the defendant here).

Although a detailed analysis of the numerous circuit court cases involving this issue would unduly lengthen this petition, the following summary shows the conflicting views expressed among and within some of the circuits:

(a) *First Circuit.* "Clearly erroneous" rule applied to stipulated and undisputed facts: The *Texas Company v. R. O'Brien & Company, supra; Collins v. Commissioner*, 216 F. 2d 519 (1st Cir. 1954).

(b) *Second Circuit.* "Clearly erroneous" rule not applied to inferences of ultimate fact to be drawn from stipulated facts or documentary evidence: *Kraft Foods Company v. Commissioner*, 232 F. 2d 118 (2d Cir. 1956); *Irvani Mottaghi v. Barky Importing Company*, 244 F. 2d 238 (2d Cir. 1957); cert. den. 354 U. S. 939 (1957).

(c) *Third Circuit.* Conflict within the circuit. "Clearly erroneous" rule not applied to ultimate facts: *Sears Roebuck and Company v. Johnson*, 219 F. 2d 590 (3rd Cir. 1955); *United States v. One 1950 Buick Sedan*, 231 F. 2d 219 (3rd Cir. 1956); *Kilby v. Folsom*, 238 F. 2d 699 (3rd Cir. 1956); *Curtis Company v. Commissioner*, 232 F. 2d 167 (3rd Cir. 1956); *Philber Equipment Corporation v. Commissioner*, 237 F. 2d (3rd Cir. 1956) and *Electric Materials Company v. Commissioner*, 242 F. 2d 947 (3rd Cir. 1957). Contra: *Sharpless v. United States*, 221 F. 2d 574 (3rd Cir. 1955) and the instant case.

(d) *Fifth Circuit.* "Clearly erroneous" rule not applied to ultimate facts: *Galena Oaks Corporation v. Scofield*, 218 F. 2d 217 (5th Cir. 1954); *Bullock v. Tamiami Trail Tours, Inc.*, 266 F. 2d 326 (5th Cir. 1959); *Daniel v. First National Bank of Birmingham*, 228 F. 2d 803 (5th Cir. 1956).

(e) *Sixth Circuit.* Conflict within circuit. "Clearly erroneous" rule applied to conclusions and inferences drawn from uncontradicted facts: *Commissioner v. Consolidated Premium Iron Ores, Ltd.*, 265 F. 2d 320 (6th Cir. 1959); *Rich v. Pappas*, 229 F. 2d 308 (6th Cir. 1956); *Gotfredson v. Commissioner*, 217 F. 2d 673 (6th Cir. 1954); cert. den. 350 U. S. 846 (1955). "Clearly erroneous" rule not applied to ultimate conclusions on uncontradicted facts:

Yunker v. Commissioner, 256 F. 2d 130 (6th Cir. 1958); *E. H. Sheldon and Company v. Commissioner*, 214 F. 2d 655 (6th Cir. 1954).

(f) *Seventh Circuit.* Conflict within circuit. "Clearly erroneous" rule applied: *Chicago, B. & Q. Railroad v. United States*, 221 F. 2d 811 (7th Cir. 1955); *Chandler v. United States*, 226 F. 2d 403 (7th Cir. 1955). Contra: *Chicago Title and Trust Company v. United States*, 209 F. 2d 773 (7th Cir. 1954).

(g) *Ninth Circuit.* Conflict within circuit. "Clearly erroneous" rule applied: *Azevedo v. Commissioner*, 246 F. 2d 196 (9th Cir. 1957); *Rollingwood Corporation v. Commissoner*, 190 F. 2d 263 (9th Cir. 1951). Contra: *Stevenot v. Norberg*, 210 F. 2d 615 (9th Cir. 1954).

(h) *Tenth Circuit.* "Clearly erroneous" rule applied to inferences and conclusions drawn from undisputed facts: *Lamb v. I. C. C.*, 259 F. 2d 358 (10th Cir. 1958).

The foregoing indicates the need for clarification of this issue by this Court. The instant case shows that resolution of this issue is not merely an academic exercise but would prevent inequitable results such as that involved here, where, by reason of the deference given the Commissioner's action by the District Court, and the deference given to the District Court's conclusions by the Court of Appeals, the Petitioner has not received any significant judicial review of the issue involved.

2. Conflict on Merits With Principles Established by This Court.

The decison of the Court of Appeals affirming the holding of the District Court as to the nature of the assessment credit, or "dividend", is in direct conflict with the characterization of such dividends adopted by this Court in *Penn Mutual Life Insurance Company v. Lederer*, 252 U. S. 523

(1920), (involving the taxation of insurance companies) where this Court speaking through Mr. Justice Brandeis stated (pp. 525-526):

> "In a mutual company whatever the field of its operation, the premium exacted is necessarily greater than the expected cost of the insurance, as the redundancy in the premium furnishes the guaranty fund out of which extraordinary losses may be met, while in a stock company they may be met from the capital stock subscribed. It is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder. Some payment to the policyholder representing such excess is ordinarily made by every mutual company every year; but the so-called repayment or dividend is rarely made within the calendar year in which the premium (of which it is supposed to be the unused surplus) was paid."

There is no dispute that Section 7(d) was intended by Congress to adopt precisely the type of mutual plan so described by this Court. The then Chairman of the Board of the FDIC, which drafted the bill, testified before the Senate Committee considering the bill (Hearings Before the Subcommittee on Federal Reserve Matters of the Senate Committee on Banking and Currency, 81st Cong. 2nd Sess. (1950), pp. 24-25):

> "The *dividend credit plan* in the bill provides that the Corporation, at the end of each calendar year, will deduct from the assessments paid by banks in that year operating costs, insurance losses and certain other items such as additions to reserves for losses. Of the net assessment income, 40 percent will be added to the Corporation's capital funds and 60 percent will be available for a pro rata division among the insured banks *as a dividend credit* applicable on the following

year's assessments. There is nothing new about this plan. *Generally it follows the 110-year-old pattern set by mutual insurance.*" (Emphasis added.)

Throughout the legislative hearings on Section 7(d) and in the Committee Reports, Congress explicitly referred to the assessment credit, or dividend (as it was sometimes called), as designed to reduce the assessment or premium for normal years by a return of part of such assessment in the form of an assessment credit available for use against the next year's assessment. *Senate Hearings, supra* (pp. 101-102); H. Rep. 2564, 1950 U. S. Code Cong., Serv., pp. 3765, 3767, 3769, 3770.

Both the majority and dissenting opinions in the Court of Appeals recognize that Congress in Section 7(d) adopted an insurance dividend plan. Thus, the majority opinion stated (p. 12a, *infra*):

> "It is obvious, of course, that there was both the desire and the effort to reduce the ultimate cost of deposit insurance to member banks. The method adopted, as was generally understood, was to preserve inviolate the fixed assessment and to pass on the benefit of 'good years' by way of 'dividend' payments."

And the dissenting opinion written by Chief Judge Biggs stated (p. 13a, *infra*) that: "The refund is analogous to payment by way of returns from a mutual insurance company to a policyholder."

Having reached this point, the conclusion required by the decision of this Court in the *Penn Mutual Insurance* case, *supra*, was that the assessment credit which Petitioner received in 1952 constituted a return of a portion of its 1951 assessment. However, instead, the majority opinion concluded (p. 12a, *infra*):

> "Nothing, however, impels the conclusion that Section 7(d) of the Act provides for a refund of any

specific prior assessment rather than the distribution of FDIC's surplus assessment income."*

The far reaching impact of this conflict with the principles enunciated by this Court in the *Penn Mutual* case on the administration of the tax laws is shown by the fact that at present dividends on mutual insurance generally are taxed only if the premiums were deducted for income tax purposes. See G. C. M. 10798, XI-2 C. B. 58; I. T. 2646, XI-2 C. B. 59; I. T. 2764, XIII-1 C. B. 45, 46; I. T. 3632, 1943 C. B. 114. The basis for these rulings is that the "dividend" constitutes a return of a portion of the premium paid, which is in accord with the decision of this Court in *Penn Mutual*, *supra*. On the other hand, the decision of the Court of Appeals here affirms a holding that mutual insurance dividends are not returns of "particular" premiums paid and therefore are taxable income without regard to whether they were ever deducted.

3. Significance of the Case for All Banks.

The decision is of the greatest importance not only because it affects numerous other mutual savings banks throughout the country, which all became subject to income tax for the first time in 1952, but also because it will apply with equal force to commercial banks which receive assessment credits based upon assessments paid in years in which they received no tax benefit from them. For example, a commercial bank, because of sufficient other deductions to offset its taxable income, may have no further taxable income for a particular year against which the FDIC premium can be deducted and may not be able to utilize the unusable deduction even by way of a net operating loss carryback or

* Since Petitioner's pro rata share of such "surplus assessment income", which it received by way of credit, was just as much a portion of the assessment it paid as its total assessment was its pro rata share of the FDIC's total assessment income, this reasoning is clearly self-contradictory.

carryover. When such a bank receives its FDIC credit based upon its assessment for such a year in which it had no income from which to deduct the assessment, is it nonetheless to be required to pay a tax upon it? It has not heretofore had to do so and if the law is now to be so changed, the effect will be to favor the successful bank which receives a tax benefit by deducting from its income its FDIC premiums and to penalize its less prosperous sister which, because of losses, has no net taxable income against which such deduction can be taken. As Chief Judge Biggs expressed it in his dissenting opinion:

> "The result reached by the majority opinion is to make the taxpayer pay as an extra 'premium' for its deposit insurance the amount of $139,200.00 with interest, collected by the United States by way of tax assessment."

(See tabulation in ¶ 5 of the Petition for Rehearing filed in the Court of Appeals.)

CONCLUSION.

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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Appendix.

OPINION SUR MOTIONS OF PLAINTIFF AND DEFENDANT FOR JUDGMENT ON THE PLEADINGS OR FOR SUMMARY JUDGMENT.

Before KIRKPATRICK, J.

This is a suit to recover federal income taxes in the amount of $139,200.33, alleged to have been erroneously assessed, paid by the plaintiff for the year 1952. All of the relevant facts appear in a stipulation. Both parties have filed motions for judgment on the pleadings or for summary judgment.

The stipulation is, in substance, as follows: The plaintiff is a mutual savings bank whose deposits are insured under the Federal Deposit Insurance Act (12 U. S. C. A. 1811 et seq.). It files its income tax returns and keeps its books on the accrual basis. Under Section 7(a) of such act the plaintiff must pay to the Federal Deposit Insurance Corporation each year an assessment at the rate of one-twelfth of one per cent of its deposit liability. Section 7(d) of the act requires that from such assessments received from insured banks the Federal Deposit Insurance Corporation must pay operating costs and losses, leaving a "net assessment income", sixty per cent of which must be credited pro rata to each insured bank after the close of the year. In 1952, there accrued to the plaintiff in this manner a credit in the amount of $281,782.05, based on the assessment it paid to the Federal Deposit Insurance Corporation in 1951. Mutual savings banks were not subject to federal income tax in 1951. In its return for 1952 (the first year for which such mutual savings banks were subject to tax) the plaintiff did not include the amount of such credit in its gross income.

The Commissioner determined that the credit was taxable income for the year 1952, and the plaintiff paid the additional tax, filed claim for refund and brought this suit, contending that since there was no tax in 1951 it got no tax benefit from the assessment which might have been deducted as a business expense had there been any income tax in that year and that the assessment credit, therefore, constituted a recovery of an expenditure which had not reduced its taxable income and was a nontaxable return of capital rather than taxable income.

The tax benefit rule, as embodied in the taxing statutes, upon which the plaintiff bases its position in this case had its origin in the recognition of the hardship involved in the decisions of some courts to the effect that bad debt recoveries constitute taxable income regardless of the tax benefit from the charge-off. It was enacted into law in Section 22(b)(12) of the 1939 Internal Revenue Code (in force for the year involved here). This section provided that income attributable to the recovery of a "bad debt, prior tax, or delinquency amount" which in the year of its occurrence did not result in a reduction of the taxpayer's tax should be excluded from the taxpayer's gross income. In 1944 the Commissioner adopted a regulation (Reg. 111 Sec. 29.22(b)(12)-1) applying the rule of exclusion prescribed by the statute to "all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years . . ." Later on, in 1955, he issued a ruling (Rev. Rul. 478, 1955-2 C. B. 18) applying specifically to Federal Deposit Insurance Corporation's credits to mutual savings banks such as the plaintiff, stating that such credits constitute taxable income and that they "do not represent recoveries of any particular expenditures made in years beginning prior to December 31, 1951."

If this ruling correctly states the law, the Commissioner did not err when he determined that the plaintiff's 1952 credits constituted taxable income.

Of course, a ruling by the Commissioner does not, like a regulation, have the effect of law, but this ruling was a general one interpreting one of the Commissioner's own regulations and it certainly amounts to a statement of what he understood and intended the limitation of the scope of Regulation 111 to be, namely, that it did not apply to mutual savings banks so far as Federal Deposit Insurance Corporation credits were concerned.

The plaintiff argues that this ruling of the Commissioner "is completely contrary to the principles previously followed by the Treasury and established by the courts, including the United States Supreme Court in the Dobson case".* I believe, however, that the plaintiff has not interpreted correctly the scope of the Dobson decision. What the Court decided in that case, and the only thing that it decided, was that the fact finding tribunal (in that case, the Tax Court) was free to find as fact that the recovery of a prior loss (in that case through a third party's fraud) was not taxable income and that in arriving at that conclusion the Tax Court's decision to the effect that, regarding the series of transactions as a whole, no gain to the taxpayer was actually realized was "no more reviewable than any other question of fact". The Court said "In determining whether the recoveries were taxable gain, however, the Tax Court was free to decide for itself what significance it would attach to the previous reduction of taxable income as contrasted with reduction of tax". The Court, however, made it doubly clear that the question was one of proper tax accounting, that is, of fact and not of law, saying "We are not adopting any rule of tax benefits . . . The error of the Court below" (that is, the Court of Appeals, which reversed the Tax Court) "consisted of treating as a rule of law what we think is only a question of proper tax accounting". The logic of the opinion is such that the Supreme Court would have sustained the Tax Court whichever

* Dobson v. Commissioner, 320 U. S. 489 (1943).

way that Court had decided the question of the existence of taxable income.

Entirely apart from the Commissioner's ruling quoted above, I am of the opinion that in the present case, as a matter of fact, the 1952 credits constitute taxable income for that year and that they are not recoveries of overpayments of deposit insurance assessments nor specific reductions of any particular assessments.

The transactions wherein the 1951 assessment was calculated and paid and the 1952 assessment was calculated and paid in cash and by a credit received in that year were separate transactions even though the 1952 credit was calculated on the basis of the 1951 net assessment income of the Federal Deposit Insurance Corporation. If the credit had been the return of an overassessment erroneously made, its allowance might have been considered a "recovery" of a part of an expenditure made in 1951 and the assessment and subsequently allowed credit could have been viewed as steps in a single transaction occurring, for tax accounting purposes, in 1951. However, the 1951 assessment was not erroneous, nor, although the credit resulted in economic gain to the taxpayer in 1952, could it be called a "recovery" of money paid by it. There was no certainty that any credit would be received. The bank could not transfer it or realize upon it or avail itself of it in any way except for the single limited purpose of reducing the payments required of it in 1952, that is, the year following that in which the assessments were made and the premiums paid. The assessment in 1951 was, of course, paid partly in cash and partly by credit calculated on the basis of prior years.

Although, had there been any tax in 1951, the bank might have deducted the payment of its assessment for that year as a business expense, it cannot be said that it incurred a loss when it paid its 1951 assessment. It bought and paid for something of value to it in its business, namely, the status of an insured bank. The assessments are not tentative assessments nor, except upon an uncertain con-

tingency, does the law require the return of any part of the premium. Only if the Federal Deposit Insurance Corporation operated in such a manner that its assessment income exceeded its expenses and losses was it obliged to credit 60% of this profit to member banks.

I cannot say that the plaintiff has established that the Commissioner was in error when he required the plaintiff (as well as mutual savings banks in general) to treat the credit as income for the year when it was actually granted. This accounting procedure seems to me to be perfectly proper. The same result would be reached if the credit, instead of being treated as income, were regarded as a reduction of the 1952 assessment and only the amount actually paid by the bank were considered a business expense. To treat the credit received as a reduction of the prior year's expenses seems to me to be contrary to the intent of Congress when it limited the application of the credit it granted to the reduction of the next year's assessment. Regardless of the bookkeeping techniques involved, this is what actually happens, because the bank actually parts with only the difference between the assessment and the credit allowed during any one year.

The motion of the plaintiff is denied, and the motion of the defendant is granted. Judgment may be entered for the defendant and against the plaintiff.

ORDER.

Before KIRKPATRICK, *J.*

AND NOW, to wit; September 25, 1958 in accordance with the opinion of the Court this day filed, Plaintiff's motion for judgment on the pleadings or for summary judgment is DENIED, and Defendant's motion is GRANTED, and it is farther

Ordered that judgment be and the same is hereby entered in favor of Defendant, United States of America and against the Plaintiff, The Philadelphia Saving Fund Society, with costs.

By THE COURT,

Attest: R. J. GREENWOOD,
Deputy Clerk.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,773

THE PHILADELPHIA SAVING FUND SOCIETY,
Appellant

v.

UNITED STATES OF AMERICA

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Argued February 17, 1959

Before BIGGS, *Chief Judge*, and MCLAUGHLIN and KALODNER, *Circuit Judges*.

OPINION OF THE COURT

(Filed July 20, 1959)

By KALODNER, *Circuit Judge*.

Plaintiff taxpayer brought this action to obtain a refund of federal income taxes paid with respect to its taxable year 1952. The facts being stipulated, both parties filed motions for summary judgment. The District Court entered judgment, via its Order, for the United States,[1] and the taxpayer took this appeal.

1. The District Court's opinion is reported at 167 F.Supp. 814 (E.D. Pa. 1958).

The issue presented for determination is whether the District Court erred in its holding that a credit received by the taxpayer, a mutual savings bank, from the Federal Deposit Insurance Corporation in 1952, when the taxpayer first became subject to federal income taxation, is taxable income for that year.

The taxpayer contends that the credit when allowed in 1952 constituted a return to it of a portion of its assessment paid in 1951, and was a nontaxable recovery because it received no tax benefit from the payment of its 1951 assessment. The United States contends that the credit did not represent an adjustment for overpayment, nor was it a specific reduction of any particular prior assessment; hence, the credit was income within Section 22(a) of the Internal Revenue Code of 1939.

The facts are as follows:

The taxpayer is a mutual savings bank whose deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") under the Federal Deposit Insurance Act, 64 Stat. 873, 12 U.S.C. 1952 ed., Sec. 1811, et seq. Insofar as relevant here, the taxpayer keeps its books and files its tax returns on a calendar year, accrual basis. Section 7(a) of the Federal Deposit Insurance Act, 12 U.S.C., 1952 ed., Sec. 1817(a), fixes the assessment to be paid to the FDIC by an insured bank at one-twelfth of one per cent of its "deposit liability", determined in accordance with the provisions of the Act. Section 7(d) of the Act, 12 U.S.C., 1952 ed., Sec. 1817(d), provides for a credit from the "net assessment income," as of December 31,—annually, of the FDIC to be applied toward the payment of the semi-annual assessment period beginning the next July 1, any excess credit being applicable to the payment of ensuing assessments.[2] Thus, the credit is computed and made avail-

2. "(d) As of December 31, 1950, and as of December 31, of each calendar year thereafter, the Corporation shall transfer 40 per centum of its net assessment income to its capital account and the balance of the net assessment income shall be credited pro rata to

able to insured banks in the following calendar year to use in payment of future assessments, or if an insured bank ceases to be insured, the amount is paid in cash.

On January 15, 1951, the taxpayer, paid to the FDIC the semi-annual assessment due for the six months ending June 30, 1951, of $247,442.48, which it paid by check.

On June 20, 1951, there was placed to taxpayer's credit [3] by the FDIC, pursuant to Section 7(d) of the Act, the amount of $278,985.34 as its pro-rata share of FDIC's net assessment income for the year 1950. On July 15, 1951, the taxpayer paid to the FDIC the semi-annual assessment for the six months ending December 31, 1951, by application of $251,264.09 of the credit standing to its account. On January 15, 1952, the taxpayer paid to the FDIC the semi-annual assessment due for the six months ending June 30, 1952, in the amount of $257,538.01, by

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the insured banks based upon the assessments of each bank becoming due during said calendar year. Each year such credit shall be applied by the Corporation toward the payment of the total assessment becoming due for the semiannual assessment period beginning the next ensuing July 1 and any excess credit shall be applied upon the assessment next becoming due. The term 'net assessment income' as used herein means the total assessments which become due during the calendar year less (1) the operating costs and expenses of the Corporation for the calendar year; (2) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added; and (3) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves. If the above deductions exceed in amount the total assessments which become due during the calendar year, the amount of such excess shall be restored by deduction from total assessments becoming due in subsequent years."

3. The "credit memorandum" issued by the FDIC provides in pertinent part: "The Federal Deposit Insurance Act provides that each insured bank shall be credited annually with its pro-rata share of sixty percent of the corporation's net assessment income for the preceding calendar year. . . . If the credit exceeds the assessment due, the excess will be deductible from the assessment due on or before the following January 15." It appears that credits are normally determined in June for the prior year.

application of the balance of its 1950 credit in the amount of $27,721.25 and by check in the amount of $229,816.76. On June 20, 1952, the FDIC placed to the taxpayer's credit, pursuant to Section 7(d) of the Act, the amount of $281,782.05, as its pro-rata share of FDIC's net assessment income for the year 1951. On July 15, 1952, the taxpayer paid to the FDIC the semi-annual assessment for the period ending December 31, 1952, in the amount of $266,411.71 by partial application of the said credit. (The unused balance of $15,370.34 of the credit was applied by the taxpayer in partial payment of the assessment which became due on January 15, 1953, for the six months ended June 30, 1953).

On its federal income tax return for the year 1952, the first year for which the taxpayer became subject to tax, (earlier exemption under Section 101(2), Internal Revenue Code of 1939, was repealed by Section 313(a), Revenue Act of 1951, c. 521, 65 Stat. 452), it deducted $523,949.72 as an ordinary and necessary business expense, that being the sum of its semi-annual assessments for that calendar year. The taxpayer did not include in its gross income for the year 1952 the amount of $281,782.05 representing the credit which it received on June 20, 1952.

The Commissioner of Internal Revenue determined that the credit of $281,782.05, which accrued to the taxpayer on June 20, 1952, was taxable income for the year 1952, but did not disturb, insofar as relevant here, the deduction in the amount of $523,949.72.[4] Taxpayer filed a timely claim for refund, which was rejected; hence this suit.

The District Court determined that the 1952 credits were not recoveries of overpayments of deposit insurance assessments nor specific reductions of any particular

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4. Rev. Rul. 62. 1953-1 Cum. Bull. 71; Rev. Rul. 55-478, 1953-2 Cum. Bull. 18.

assessments; that the taxpayer had bought and paid for something of value, and did not incur a loss when it paid its 1951 assessment; that the assessments, under the Act, are not tentative assessments; and that only if the FDIC operated in such manner that its assessment income exceeded its expenses and losses was it obliged to credit the 60% of profit to member banks. Accordingly, it concluded that the credit involved was income, and that it could not say that the Commissioner was in error.

We start with the principle, that Section 22(a) of the Internal Revenue Code of 1939 states the taxing power. It sweeps with a wide, stiff brush, and gets into the corners. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429-430 (1955). The burden undeniably rests upon the taxpayer to take the credit here involved out of the income class, and to show that the Commissioner was wrong. Taxpayer also has the burden of showing that the District Court plainly erred.

Under Section 7(a) of the Federal Deposit Insurance Act, the assessment is absolute, not contingent. It is deductible when paid or accrued. Indeed, as the taxpayer points out, the total assessment, unreduced by any credit, under Section 7(d), is used in determining the pro-rata share of the net assessment income of the FDIC to which an insured bank may become entitled; the credit is applied as a payment against the assessments to become due according to the specific directive of the statute. Thus, the credit is a distribution of the stated percent of the FDIC's assessment income after expenses and losses (including additions to reserves) for the calendar year are determined, each insured bank being entitled to a pro-rata share thereof measured by its assessment for that year, and even though its assessment may have been paid in whole or in part by the application of a credit or credit balance.

In the terms of the Act, we find no basis for a conclusion that the District Court clearly erred. For it does

not appear to us that the credit may be characterized as an overpayment, or as a retroactive reduction of particular assessments paid, with respect to the calendar year in which FDIC's operations resulted in credits.

The taxpayer relies upon legislative history to support its contention that the credit accrued to it in 1952 was a return of a portion of its 1951 assessment.[5] It is obvious, of course, that there was both the desire and the effort to reduce the ultimate cost of deposit insurance to member banks. The method adopted, as was generally understood, was to preserve inviolate the fixed assessment and to pass on the benefit of "good years" by way of "dividend" payments. Nothing, however, impels the conclusion that Section 7(d) of the Act provides for a refund of any specific prior assessment, rather than the distribution of FDIC's surplus assessment income. And, as we have stated, Section 7(d) does not purport to reduce assessments for the prior year in the operation of the FDIC, insofar as the determination of its net assessment income is concerned, or in the liability of member banks for assessments under Section 7(a) of the Act.

We cannot conclude, therefore, that the District Court was plainly wrong in its determination that the credit here involved was neither a retroactive recovery nor a reduction of the prior year's expenses, but constituted taxable income under Section 22(a) of the Internal Revenue Code of 1939.

For the reasons stated, the Order of the District Court will be affirmed.

5: Particularly, H. Rep. No. 2564, 81st Cong., 2d Sess., 2 U.S.C. Cong. & Adm. News (1950), 3765, 3767, 3770; Hearings before the Sub-Committee of the Committee on Banking & Currency, on Bills to Amend the Federal Deposit Insurance Act, 81st Cong., 2d Sess. (1950), pp. 101-102. Reference is made by the United States to S. Rep. No. 1269, 81st Cong., 2d Sess.; and 96 Cong. Record, Part 8, pp. 10648-10671, in addition to the foregoing generally.

Biggs, *Chief Judge*, dissenting.

The credit which accrued to the taxpayer in 1952 was a recovery of a portion of the taxpayer's 1951 assessment. The credit did not constitute taxable income to the taxpayer because the 1951 assessment was not connected with any corresponding tax benefit in 1951. Had the taxpayer been subject to income tax in 1951 (which it was not) it could have deducted the amount of the assessment as an ordinary and necessary expense of doing business. "When a taxpayer receives . . . a refund of an expenditure made in a previous year that refund is [treated as] a return of capital unless he has retained some advantage from the initial expenditure." Bartlett v. Delaney, 75 F. Supp. 490, 493 (D. Mass. 1948), aff'd 173 F.2d 535 (1 Cir. 1949), cert. den. 338 U.S. 817. Though there was an advantage to the taxpayer in paying the assessment since it gained deposit insurance thereby, the refund was nonetheless governed by Section 7(d) of the Federal Deposit Insurance Act, 12 U.S.C.A. § 1817(d) (1952) and was within the statutory exclusion expanded by the Supreme Court in Dobson v. Commissioner, 320 U.S. 489 (1943), for the recovery of items not specifically mentioned in Section 22(b)(12) of the Internal Revenue Code of 1939. The refund is analogous to payment by way of returns from a mutual insurance company to a policy holder. This is what Congress had in mind as demonstrated by the legislative history. See Hearings before the Sub-Committee on Federal Reserve Matters of the Senate Committee on Banking and Currency, on Bills to Amend the Federal Deposit Insurance Act, 81st Cong., 2nd Sess. (1950) at pp. 101-102. Indeed, the Chairman of the Board of the FDIC, testifying before the Sub-Committee, stated, "There is nothing new about this plan. Generally it follows the 110-year-old-pattern set by mutual insurance." Senate Hearings, *id.* at pp. 24-25.

The result reached by the majority opinion is to make the taxpayer pay as an extra "premium" for its deposit insurance the amount of $139,200.00 with interest, collected by the United States by way of tax assessment. I cannot believe that this was the result intended by Congress and I conclude that the taxpayer should have judgment here. For these reasons I dissent.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 12,773.

THE PHILADELPHIA SAVING FUND SOCIETY,
Appellant,

v.

UNITED STATES OF AMERICA.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Present: BIGGS, *Chief Judge* and MCLAUGHLIN and KALODNER, *Circuit Judges.*

JUDGMENT.

This cause came on to be heard on the record, from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest: IDA O. CRESKOFF,
Clerk.

July 20, 1959

FILE COPY

Office-Supreme Court, U.S.
FILED
DEC 24 1959
JAMES R. BROWNING, Clerk

No. 543

In the Supreme Court of the United States

OCTOBER TERM, 1959

THE PHILADELPHIA SAVING FUND SOCIETY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 543

THE PHILADELPHIA SAVING FUND SOCIETY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. 7a–14a) is reported at 269 F. 2d 853. The opinion of the District Court (Pet. 1a–5a) is reported at 167 F. Supp. 814.

JURISDICTION

The judgment of the Court of Appeals was entered on July 20, 1959 (Pet. 15a). A timely petition for rehearing was denied on September 22, 1959. The petition for a writ of certiorari was filed on November 25, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a Federal Deposit Insurance Corporation credit received by taxpayer, a mutual savings bank, during the year 1952 constituted taxable income for that year.

STATUTES, REGULATIONS, AND RULINGS INVOLVED

Section 7 (a), (d), and (e) of the Federal Deposit Insurance Act; Section 22(b)(12) of the Internal Revenue Code of 1939; Section 39.22(b)(12)–1 of Treasury Regulations 118; and Rev. Rul. 55–478 are set forth in the Appendix, *infra*, pp. 10–13.

STATEMENT

This case concerns the inclusion in gross income of the taxpayer for the year 1952 of a sum which accrued to it in that year as a credit from the Federal Deposit Insurance Corporation. The facts, which are not in dispute, are as follows:

The taxpayer is a mutual savings bank whose deposits are insured under the Federal Deposit Insurance Act (64 Stat. 873, 12 U.S.C. 1811, *et seq.*). It files its income tax returns and keeps its books on the accrual basis. Under Section 7(a) of the Act, the taxpayer must pay to the Federal Deposit Insurance Corporation each year an assessment at the rate of one-twelfth of one percent of its deposit liability. Section 7(d) of the Act requires that from assessments received from insured banks the FDIC must pay (1) its operating costs and expenses for the calendar year, (2) additions to reserve to provide for insurance losses during the calendar year, and (3) the insurance losses sustained in the calendar year

plus losses from any preceding years in excess of reserves. The balance remaining to the FDIC from the assessments is termed the "net assessment income", sixty percent of which must be credited pro rata (on the basis of that year's assessments) to each insured bank after the close of the year. In 1952 there accrued to the taxpayer in this manner a credit in the amount of $281,782.05. (Pet. 1a.)

On its federal income tax return for the year 1952, the first year for which the taxpayer became subject to the tax,[1] it deducted $523,949.72 as an ordinary and necessary business expense, being the sum of the two deposit-insurance assessments for that calendar year. (R. 6a.)[2] The taxpayer did not include in its gross income for the year 1952 the amount of $281,782.05 representing the credit which it received on June 20, 1952, nor did it reduce its expense deduction of $523,949.72 by the amount of the credit which was applied against that expense. (R. 5a, 6a, 10a.)

The Commissioner of Internal Revenue determined that the credit of $281,782.05 was taxable income for the year 1952. (R. 4a, 5a, 6a, 10a–11a.) Taxpayer paid the additional tax and then brought this suit for refund. (R. 4a, 5a, 6a, 10a–11a.) On motions filed by both parties for judgment on the pleadings or for summary judgment (Pet. 1a), the District Court entered judgment for the United States (Pet. 6a).

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[1] The taxpayer was previously exempt under Section 101(2) of the Internal Revenue Code of 1939, which was repealed by Section 313(a), Revenue Act of 1951, 65 Stat. 452.

[2] "R." refers to the taxpayer's appendix in the Court of Appeals.

The Court of Appeals, by a divided court, affirmed (Pet. 7a–14a).

ARGUMENT

The situation presented by this case is a narrow one which in its nature probably will never recur subsequent to the taxable year here involved. It does not present a question of general importance, the decisions below are correct, and there is no conflict of decisions. There appears to be no occasion for further review.

The sole question is whether a FDIC credit in the amount of $281,782.05, which accrued to the account of taxpayer on June 20, 1952, constitutes taxable income to the taxpayer during that year. The taxpayer's entire argument is predicated upon its allegation that the 1952 credit represents the recovery of an overpayment of deposit-insurance assessments in 1951. Since the taxpayer was exempt from income taxation in 1951,[3] its deduction of the assessments when paid gave it no tax benefit. Hence it claims that its "recovery" of the overpayments in 1952 should not, under the "tax-benefit" rule, be taxable to it. In our view, however, there are at least two reasons why the tax benefit rule is not applicable. The first is that the FDIC credit does not represent the recovery of an overpayment by taxpayer of any particular deposit-insurance assessment; the second is that the tax benefit rule does not apply where the reason that no tax benefit was received was that the taxpayer was completely exempt from taxation during the earlier year.

[3] See note 1, *supra*.

1. There is no dispute that the credit is within the broad definition of "gross income" of Section 22(a) of the 1939 Code (see *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426) unless it is excludable by virtue of the tax benefit rule. Section 22(b)(12) (*infra*, p. 11) grants an exclusion for the "recovery" during the taxable year of a bad debt or a tax for which a deduction was "allowed" in a prior year if that deduction "did not result in a reduction of the taxpayer's tax under this chapter". Under the Treasury Regulations, that rule is not limited to the items specifically enumerated (bad debts and taxes) but applies as well "to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years." Regulations 118, Section 39.22(b)(12)–1 (*infra*, p. 12). The Commissioner has ruled specifically, however, that the exclusion does not apply to FDIC credits and that such credits constitute income in the year received or accrued. Rev. Rul. 55–478, 1955–2 Cum. Bull. 18 (*infra*, p. 13); see also Rev. Rul. 62, 1953–1 Cum. Bull. 71. That ruling is clearly correct, for the FDIC credit represents, not a "recovery" of a particular prior payment,* but essentially a dividend of FDIC income.

* The limitation of Section 22(b)(12) and the regulations to recoveries of identifiable prior-year payments or losses simply codifies the established requirement of the tax benefit rule that there must be such an interrelationship between the event which constitutes the loss or expenditure and the event which constitutes the recovery that they can be considered as part of the same transaction. *Waynesboro Knitting Co.* v. *Commissioner*, 23 T.C. 404, affirmed, 225 F. 2d 477, 480 (C.A. 3); *Farr* v. *Commissioner*, 11 T.C. 552, affirmed, *sub nom. Sloane* v. *Com-*

The Federal Deposit Insurance Act (*infra*, p. 10) provides that member banks are to be assessed at the rate of one-twelfth of one percent per annum of their "deposit liability" (§ 7(a)). The assessments less operating costs, additions to reserve, and insurance losses constitute the "net assessment income" of the FDIC (§ 7(d)). The Act provides that during each year the FDIC shall transfer forty percent of its net assessment income to its capital account, and the balance of its net assessment income is to "be credited pro rata to the insured banks based upon the assessments of each bank becoming due" during the calendar year in question (§ 7(d)). By its terms, the Act makes clear that it is the income of the FDIC which is being credited to the member banks ("the Corporation shall transfer 40 per centum of its net assessment income"), rather than a refund of an overpayment to the members of their earlier expenditures.[5] In sharp contrast to those provisions is the express provision for refunds of actual overpayments of assessments. Section 7(e) provides that the FDIC—

> (1) may refund * * * any payment of assessment in excess of the amount due to the Corporation or (2) may credit such excess toward

missioner, 188 F. 2d 254, 262–263 (C.A. 6); *Allen* v. *Trust Co. of Georgia*, 180 F. 2d 527 (C.A. 5), certiorari denied, 340 U.S. 814.

[5] That interpretation accords with the legislative history. See Hearings before a Subcommittee of the Senate Committee on Banking and Currency, Bills to Amend the Federal Deposit Insurance Act, 81st Cong., 2d Sess.; S. Rep. No. 1269, 81st Cong., 2d Sess.; H. Rep. No. 2564, 81st Cong., 2d Sess.; 96 Cong. Rec. 10648–10671.

> the payment of the assessment next becoming due from such bank * * *.

A Section 7(e) refund or credit of an overpayment clearly constitutes a "recovery" of a prior expenditure within the meaning of the tax benefit rule and, by contrast, emphasizes the different nature of the Section 7(d) income credit. Section 7(d) provides, not for a "refund" of prior payments, but simply for the equitable distribution of the FDIC's excessive assessment income.[8]

2. Even should it be assumed for the purposes of argument that the 1952 credit constituted a recovery of a portion of the taxpayer's 1951 deposit insurance assessments, it is the position of the Government that the tax benefit rule, as codified in Section 22(b)(12) of the 1939 Code and the regulations, would nevertheless not apply. The only reason that the 1951 assessments did not result in a reduction of taxpayer's income tax in 1951 is that prior to 1952 the taxpayer was entirely exempt from income taxation. Thus, the taxpayer, in effect, is arguing that the credit which it admittedly received in 1952, and which, under the fixed annual accounting principle (see *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359) is income for

[8] *Penn Mutual Life Ins. Co.* v. *Lederer*, 252 U.S. 523, held that under the express provisions of the Revenue Act of 1913 dividends paid out by a mutual insurance company were not deductible from its premium income. In what way that decision is thought to conflict with the decision below (Pet. 10–13) is not apparent, and nothing in the Court's introductory description of the operation of a mutual company quoted by petitioner (Pet. 11) touches on the issue here—the characterization of the FDIC credit *for purposes of the tax benefit rule.*

that year, cannot be treated as income since prior to 1952 Congress had not seen fit to tax its income. It is apparent, however, that the exclusion of the 1952 credit from taxpayer's gross income for that year, while at the same time allowing a full deduction for its 1952 assessment against which the credit was applied, would distort its income for the first year it is subject to tax. That result, we think, is not required by the essentially equitable purposes underlying the tax benefit rule.

The tax benefit rule had its origin in cases involving the recovery of bad debts. Under fixed annual accounting principles, the recovery on a bad debt or capital loss in a tax year subsequent to that in which the debt was charged off or the loss incurred is income in the year of recovery since, for tax purposes, one looks only to the result of the transaction in the subsequent year which is the unit of taxation. This was held to be true irrespective of whether the prior charge-off and deduction for the loss resulted in any tax benefit in the prior year.[7] It was to relieve in part such hardships arising from the annual accounting system that the tax benefit rule was evolved. No such hardship is involved, however, where the lack of a tax benefit in the prior year is due solely to the fact that the taxpayer was then totally exempt from taxation. In such a case, the taxpayer has not lost the benefit of a specific deduction to which it was otherwise entitled; it has, to the contrary, simply been the

[7] *Commissioner* v. *United States & International Securities Corp.*, 130 F. 2d 894, 897 (C.A. 3); *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44, 46–47 (C.A. 4).

recipient of an even greater benefit—to wit, total exemption from the tax. Thus, there has been no loss of a tax advantage to be compensated for by allowing an exclusion in the later year.

3. The short answer to petitioner's claim of a conflict on the scope of the "clearly erroneous" rule (Pet. 5–10) is that the decision below did not rest on that ground. Although the Court of Appeals used that formulation to some extent in stating its ultimate conclusion, it is evident from its opinion that it viewed the question as one of law and independently arrived at the same result as had the Commissioner and the District Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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DECEMBER 1959.

APPENDIX

1. Federal Deposit Insurance Act § 7, 64 Stat. 876, 12 U.S.C. 1817:

> SEC. 7. (a) The assessment rate shall be one-twelfth of 1 per centum per annum. * * *
>
> * * * * * *
>
> (d) As of December 31, 1950, and as of December 31, of each calendar year thereafter, the Corporation shall transfer 40 per centum of its net assessment income to its capital account and the balance of the net assessment income shall be credited pro rata to the insured banks based upon the assessments of each bank becoming due during said calendar year. Each year such credit shall be applied by the Corporation toward the payment of the total assessment becoming due for the semi-annual assessment period beginning the next ensuing July 1 and any excess credit shall be applied upon the assessment next becoming due. The term "net assessment income" as used herein means the total assessments which become due during the calendar year less (1) the operating costs and expenses of the Corporation for the calendar year; (2) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added; and (3) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves. If the above deductions exceed in amount the total assessments which become due during the calendar year, the amount of such excess shall be restored by deduction from total assessments becoming due in subsequent years.

(e) The Corporation (1) may refund to an insured bank any payment of assessment in excess of the amount due to the Corporation or (2) may credit such excess toward the payment of the assessment next becoming due from such bank and upon succeeding assessments until the credit is exhausted.

* * * * *

2. Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 22. * * *

* * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(12) *Recovery of bad debts, prior taxes, and delinquency amounts.*—Income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount. For the purposes of this paragraph:

(A) *Definition of Bad Debt.*—The term "bad debt" means a debt on account of worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

(B) *Definition of Prior Tax.*—The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

(C) *Definition of Delinquency Amount.*—The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time required by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

(D) *Definition of Recovery Exclusion.*—The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this chapter (not including the tax under section 102) or corresponding provisions of prior revenue laws, reduced by the amount excludible in previous taxable years with respect to such debt, tax, or amount under this paragraph.

* * * * *

3. Treasury Regulations 118:

SEC. 39.22(b)(12)-1. *Recovery of certain items previously deducted*—(a) *In general.* Section 22(b)(12) provides that income attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. The rule of exclusion so prescribed by statute applies equally with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses referred to in section 127, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums. See *Dobson* v. *Commissioner*, 320 U.S. 489. The term "recovery exclusion" as used in this section means accordingly an amount equal to the portion of the bad debts, prior taxes, and delinquency amounts (the items specifically referred to in section 22(b)(12)), and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction

of any tax of the taxpayer under chapter 1 of the Internal Revenue Code (other than a tax under section 102) or under corresponding provisions of prior revenue laws.

* * * * *

4. Rev. Rul. 55–478, 1955–2 Cum. Bull. 18:

In the case of mutual savings banks not having capital stock represented by shares, as in the case of other insured banks, Federal Deposit Insurance Corporation credits under section 7(d) of the Federal Deposit Insurance Act, 64 Stat. 873, at 877, 12 U.S.C. 1817(d), received or accrued in a taxable year beginning after December 31, 1951, constitute income for Federal income tax purposes, full deduction being allowable for the future assessments against which such credits are allowable. Such amounts received or accrued do not represent recoveries of any particular expenditures made in years beginning prior to December 31, 1951, during which such institutions were exempt from Federal income tax, but constitute gross income subject to tax in a taxable year in which received or accrued. Compare Rev. Rul. 62, C.B. 1953–1, 71 as made applicable by Rev. Rul. 214, C.B. 1953–2, 140.

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IN THE

Supreme Court of the United States

October Term, 1959.

No. 543.

THE PHILADELPHIA SAVING FUND SOCIETY,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

PETITIONER'S REPLY BRIEF.

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THE PHILADELPHIA SAVING FUND SOCIETY,
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PETITIONER'S REPLY BRIEF.

1. The Petition for Certiorari has set forth the importance of the question presented; the implications of the decision, not only for banks receiving FDIC insurance dividends, but on the taxability of insurance dividends in general; the conflict of the decision below with the principles established by this Court in *Penn Mutual Life Insurance Company v. Lederer*, 252 U. S. 523; and the conflict with decisions of this Court and other circuits on the application of the "clearly erroneous" rule. Respondent's brief (dealing primarily with the merits) nowhere explains why it believes the issue is not of general importance, nor does it say why it believes the decision does not have the implications alleged in the Petition. Moreover, its statement (p. 6) that the Court of Appeals did not base its decision on the "clearly erroneous" rule is obviously incorrect, unless it is assumed that the Court did not mean what it said.

2. In its brief, Respondent quotes (pp. 6-7) Section 7(e) of the Federal Deposit Insurance Act and concedes that a

Section 7(e) refund or credit "clearly constitutes a recovery of a prior expenditure within the meaning of the tax benefit rule." Having made such a concession, it is impossible to logically then conclude that a credit under Section 7(d) is not the recovery of a portion of a prior assessment, while a refund or credit under Section 7(e) is. In both cases, the assessment being credited has previously become part of the assessment income of the FDIC. In attempting to distinguish between Sections 7(d) and 7(e) the Respondent quotes a part of 7(e) referring to refund of a payment of an "assessment in excess of" the amount due, and points out that 7(d), on the other hand, has to do with pro rata distribution of "excessive assessment income." This certainly is a distinction without a difference.

The FDIC itself recognizes that in this respect a credit under Section 7(e) is exactly the same as under Section 7(d), the only real difference being the occasion for granting the credit. Thus, in the FDIC Regulations, 12 C. F. R., Section 327.237, it is provided:

> "§ 327.237 *Assessment Decision No. 137; refunds of assessments.* (a) An overpayment of an assessment made by an insured bank is normally credited to its account and left to apply upon the assessment next becoming due. However, upon request from the bank a refund will be made of the overpayment of assessment.
>
> (b) An assessment credit, that is, the statutory credit allowed annually based upon the net assessment income for the preceding calendar year, cannot be refunded to operating banks since section 7(d) of the Federal Deposit Insurance Act specifically provides that assessment credits shall be applied upon future assessments. However, where the insured status of a bank has been terminated, refunds of all credits, including assessment credits, will be made to the insured bank after all requirements in respect to assessments

and the termination of its insured status have been met. In lieu of a refund, a bank whose deposit liabilities have been assumed by another insured bank may assign its unused credits to the assuming bank after all requirements on assessments and the termination of its insured status are met."

Accordingly, the FDIC deals with the treatment of assessment credits under the heading "refunds of assessments" and obviously considers that such credits, just as the Section 7(e) credits, are returns of previously paid assessments. Moreover, Section 7(d) itself makes no provision for a refund of assessment credits upon termination of the insured status of a bank. Yet, the FDIC in the foregoing Regulation treats the assessment credits for this purpose as actually being under Section 7(e), and provides for a cash refund upon termination of insured status.

3. Respondent cites in support of its position, *Commissioner v. Glenshaw Glass Company*, 348 U. S. 426, and *Burnet v. Sanford & Brooks Company*, 282 U. S. 359. However, neither of those cases involved the situation where a taxpayer in one year made an expenditure and in the subsequent year recovered the same expenditure, thus realizing no gain from the transaction. In the *Glenshaw* case, this Court specifically characterized the recoveries there involved as "undeniable accessions to wealth" and in footnote 8 distinguished rulings dealing with personal injury recoveries on the ground that such recoveries "are by definition compensatory only." And in *Dobson v. Commissioner*, 320 U. S. 489, this Court pointed out that the *Sanford & Brooks* case suggested its own distinction in that it did not involve a recovery of expenditures previously made. This was also pointed out in *Plumb, The Tax Benefit Rule Today*, 57 Harv. L. Rev. 129, f.n. 8, p. 130:

"Burnet v. Sanford & Brooks Co., 282 U. S. 359 (1931), is to be distinguished. There the recovery

stood in the place of the proceeds of a contract and was true gross income, even though in a loose sense it reimbursed the expenses of performance; the items here under consideration adjust or correct previous expenses or losses.''.

4. In its argument No. 2, Respondent contends that even if the 1952 credit constituted a recovery of a portion of the taxpayer's 1951 assessments, the credit is nevertheless taxable income because the only reason the taxpayer received no tax benefit was that it was previously exempt from taxation.

This argument of Respondent is based on the notion that the tax benefit rule is designed to compensate for the loss of a previous tax advantage (See p. 9 of Respondent's brief). This totally misconceives the concept of the tax benefit rule. The basis for the rule actually is that if in one year a taxpayer makes an expenditure, which he recovers in a later year, the recovery should be taxed if the same item has previously been deducted with tax benefit. Otherwise, the taxpayer would in effect receive the benefit of a deduction for an expenditure never in fact made. On the other hand, if there has been no previous deduction with tax benefit, the taxpayer comes out even, and taxing him would result in a tax on a transaction which resulted in no economic gain. Obviously, the reason for the lack of tax benefit in the earlier year is immaterial.

The Commissioner of Internal Revenue has recognized this very principle in Rev. Rul. 58-126, 1958-1 C. B. 13. It was there ruled that a mutual savings and loan association which transferred after 1951 an amount from its reserve for losses to undivided profits did not realize taxable income where such reserve was created from profits in years prior to 1952, when the association was exempt from tax and therefore received no tax benefit from the additions to reserve. On the other hand, where the transfers from reserve affected additions to the reserve in 1952 and there-

after, when the association was subject to income tax and deducted such additions to reserve, the ruling was that the transfers did result in taxable income.

In the present case, the Respondent in effect says that Petitioner should be thankful that if was altogether exempt from income tax prior to 1952, rather than complaining that the Government is attempting to tax it on a receipt which under general principles of tax law is exempt. In other words, Respondent would discriminate against Petitioner merely because it was once tax exempt.

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